INTELLIGENCE NOTE

BUREAU OF INTELLIGENCE AND RESEARCH

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THE PETROLEUM NEGOTIATIONS: INITIAL POSITIONS

EXCISE

We now have the range of possibilities within which the companies' negotiations with the Persian Gulf countries in Tehran and with Libya in Tripoli will seek compromises. Some progress has been made in Tehran since January 28 in narrowing the differences, which are wider than the companies expected.

At Tripoli, negotiations on terms have yet to begin because the Libyan Government has continued its effort to deal with the companies separately, a maneuver also intended to put off sitting down at the negotiating table until outcome of Tehran negotiations becomes clearer.

The Libyans made known their large demands early, on January 9, doubtless in part to bring pressure on the Persian Gulf countries to take a hard position vis-a-vis the companies. The concerting companies, which now number twenty, reached an agreed position this last week. When their position was laid on the table in Tehran on January 28, the Persian Gulf negotiators countered with their detailed demands. These initial positions, together with the demands formulated in more general terms by the Organization of Petroleum Exporting Countries (OPEC) meeting at Caracas December 7-12, are compared in Table I at the end of this Note.

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The key issues are disparities in the posted prices of crude from various sources; a demanded across-the-board increase in posted prices, reinvestment by the companies in the producing countries, and the relationship between product prices and crude prices.

Disparities are a problem both because there are wide differences in position between the companies and the exporting countries and because they are an issue between Persian Gulf and Mediterranean exporting countries which exposes the companies to "leapfrogging." Libya enjoys an advantage as a short-haul source when the Suez Canal is open; it apparently evaluates this advantage at 30 cents per barrel. It enjoys an additional temporary advantage as long as the Canal is closed.

Where the Persian Gulf countries and Libya differ is in the value to be attached to the latter's permanent short-haul advantage. Transport rates vary widely, in time and on the same day, and what average transport rates on various routes are at any given time can only be guessed at, especially for the now closed Canal route. Depending on the estimate of transport costs, there could be a disparity in favor of either the Persian Gulf countries or Libya. At present the Persian Gulf countries say the 30 cent a barrel increase obtained by Libya in September overvalues Libya's permanent short-haul advantage and are asking for an offsetting increase.

The demanded across-the-board increase is a key one because it is permanent, will apply to all crude produced in Africa and the Persian Gulf, and will influence crude prices elsewhere in the world.

The companies' willingness to reinvest is of course strongly influenced by their judgment as to the security of the output thus developed. Their

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confidence has been greatly weakened by expressions of nationalist desire to control exploitation of natural resources even in relatively conservative Middle East countries like Saudi Arabia and Iran, and by the Algerian example of nationalization after inducing the companies to reinvest.

The Shah of Iran has taken the position that if the companies increase their product prices in Europe, the exporting countries will demand an offsetting increase in crude prices, and the Persian Gulf countries are following his lead. As the illustrative calculations in Tables II and III show, the companies could hardly avoid increasing product prices if, at Tehran and Tripoli, they find themselves in the position of having to accept the exporting countries' present demands or anything approaching them.

In Tehran there are indications of where there is give in the positions of the two sides. On posted prices the companies have now offered 20 cents per barrel. It appears probable that the Gulf countries are willing to trade off their demand for a fixed relationship between crude and product prices against an immediate concession on posted prices. On the other hand, they appear firm on elimination of the discounts and allowances. The companies appear prepared to accept a 1 1/2 cent reduction in posted prices for each degree of gravity between 40° and 33° with a 2 cent reduction per degree below 33°, The companies have offered an annual inflation increase on the posted price of 3 cents/bbl. The Persian Gulf negotiators have countered with a demand for 7 cents/bbl. and the companies have raised their offer to 2% of the posted price, i.e. between 4 and 5 cents. This or any higher figure will be higher than the annual increase

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given the Libyans in the September settlement [redacted] B1

[redacted]

The companies' hopes of getting Iraq and Saudi Arabia to agree on posted prices f.o.b. at their eastern Mediterranean pipeline terminals, [redacted] have been B1 dashed. The Gulf negotiators want the same terms Libya obtains and have refused to negotiate on this point.

[redacted] B1

The reinvestment demand is one the Algerians have persistently made in past with some success. The Suez premium may prove difficult to roll back when the Canal opens, and the Gulf negotiators have warned that if it is not rolled back they will insist on adjustments in their prices. [redacted] B1

[redacted]

The companies [redacted] B1, B4

[redacted] are seeking to protect themselves [redacted] by obtaining assurances (a) that if they initial an agreement with the Gulf countries the latter will not intervene in the Libyan negotiations, for example by joining Libya in cutting back production, and

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(b) that the posted prices obtained for Saudi-Arabian and Iraqi crude at eastern Mediterranean terminals will not be a pretext for seeking an increase in Persian Gulf posted prices generally.

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INITIAL POSITIONS IN PERSIAN GULF AND LIBYAN NEGOTIATIONS

Issue \ Position:	OPEC Resolutions XXI:120, 122, and 123	Libya	Persian Gulf Countries		Producing Companies
Tax rate	55% minimum	Increase from 50% to 55% 1/	55% rate extended to most P.G. countries in November		Specifically reject any increase in present tax rates
Disparities arising from failure of p.p. adequately to reflect differences in gravity and transport costs	Elimination on basis of highest p.p. applicable in any OPEC country	-Temporary Suez premium of 35¢/bbl -Short-haul premium of 30¢/bbl over P.G. p.ps.	Unspecified increase on grounds p.p. increase given Libya in Sept. greater than justified by transport costs	54¢/bbl (fob Gulf only 2/)	A temporary and variable increase in p.p. for Libyan crude related to transport costs that would amount to about 35¢/bbl during first quarter of 1971
Across-the-board increase in p.ps.	An increase not specified	Any increase obtained by P.G. countries	Unspecified		15¢/bbl
Change in p.p. adjustment for gravity differential	Reduction in p.p. by 1/5¢ for each degree of gravity below 40°, increase of 2¢ for each degree above 40°	(Probably now in effect)	As in OPEC resolution (see left)		Demand rejected
OPEC discounts	Elimination	(Already eliminated for Mediterranean)	Elimination		Demand rejected
Reinvestment of earnings	Adequate levels of exploration and development	25¢ per barrel exported	As in OPEC resolution		Demand rejected
Automatic p.p. adjustments	For changes in $ parity to maintain real value of revenues	(Obtained annual 2¢ increase through 1975 in Sept. 1970)	Annual increase along lines Libyan agreement		Annually with changes in UN value index for exports from developed to developing countri
Relationship between crude and product prices	None	None	If product prices increased in Europe, prices of crude will have to be adjusted accordingly		That exporting countries undertake not to seek further to amend concession agreements nor to raise any claims for additional payments or remittances for period of five years

p.p. = posted price.
P.G. = Persian Gulf. All prices in cents per barrel (bbl).
1/ In Sept 1970 Libya obtained from companies tax rate increases above 50% of 4% to 8% depending on company in settlement of retroactive claims. Libya contends these surcharges do not modify basic 50% rate.
2/ See text.

Table II

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Illustrative Calculations of Companies' Tax Paid Costs and Profit and Iranian Revenues per Barrel of Iranian Light Crude (31°) Exported

	Mid-1970	Initial Demands	Initial Offer	Hypothetical Outcome
1. Posted Price	$1.79	$2.42 a/	$1.94 a/	$2.21 a/ b/
2. Production Costs	.14	.14	.14	.14
3. Royalty (1 x 12.5%)	.22	.30	.24	.28
4. Tax (55% x (1 - (2 + 3)))	.79	1.09	.86	.98
5. Tax Paid Costs (2 + 3 + 4)	1.15	1.53	1.24	1.40
6. Realized Price	1.30	?	?	1.55
7. Profit (6 - 5)	.15	?	?	.15
8. Iranian Revenues (3 + 4)	1.01	1.39	1.10	1.26

a/ Takes account only of price increases applicable immediately and unconditionally.

b/ Assumes 34 cent across-the-board increase (including 4 cents for abandonment of Gulf demand that crude prices be related to those for products), acceptance of gravity differential (4 cents), and elimination of OPEC discounts (4 cents), or a 42 cent total increase.

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Table III

Illustrative Calculations of Companies' Tax Paid Costs and Profit and Libyan Revenues per Barrel of Libyan Crude (40°) Exported

	Mid-1970	October 1, 1970	Initial Demands	Initial Offer	Hypothetical Outcome
1. Posted Price	$2.23	$2.53	$3.04[a]	$3.05	$3.30[b]
2. Production Costs	.25	.25	.25	.25	.25
3. Royalty (1 x 12.5%)	.28	.32	.44	.34[c]	.41
4. Tax (60% x (1 - (2+3)))	.85	1.08	1.63	1.48	1.58
5. Tax Paid Costs (2+3+4)	1.38	1.63	2.32	2.47	2.24
6. Realized Price	1.85	?	?	?	2.50
7. Profit (6-5)	.47	?	?	?	.26[d]
8. Libyan Revenues (3+4)	1.13	1.40	2.07	1.82	1.99

a/ 35 cent Suez premium, 30 cent short haul premium over present Gulf prices plus assumed 34 cent increase in Gulf prices (Table I) to maintain short-haul premium.

b/ Assumed 35 cent Suez premium for tax and royalty purposes, and 40 cent additional increase.

c/ Companies' Suez premium offer made only for tax purposes.

d/ It is assumed companies would have to absorb part of the tax paid cost in Libya.